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No. 99-

IN THE

Supreme Court of the United States

AMILIA ABBOTT, *et al.*,

Petitioners,

v.

MEDGAR EVERS HOUSES ASSOCIATES, L.P., *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

In a civil RICO action based on predicate acts of mail and wire fraud,

1. Should the rule for pleading proximate cause incorporate the controversial "convergence theory" and require that the plaintiff must have received and relied upon the fraudulent mailings and wirings, as held by the Second and Fourth Circuits, or that the plaintiff need not have received and relied upon these mailings and wirings, provided that they directly caused plaintiff's injury, as held by the Third and Fifth Circuits?

2. Did the Court below ignore this Court's holding in *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258 (1992), by creating a black-letter rule that an injury to a plaintiff caused by misrepresentations to a third party is "necessarily derivative" of injuries sustained by the third party?

3. Did the Court below improperly engraft the element of justifiable reliance onto petitioners' cause of action, contradicting this Court's holding in the criminal context that "justifiable reliance . . . plainly [has] no place in the federal fraud statutes," in *Neder v. United States*, 527 U.S. 1, 119 S. Ct. 1827, 1841 (1999)?

LIST OF PARTIES

The names of all parties in the court whose judgment is sought to be reviewed appear below:

Petitioners:

Amilia Abbott, Kanvra Abdul-Karim; Edwin Acervedo; Carolyn Adams; Deborah Alston; Patricia Alston; Marlene Anaya; Annie Barnes; Charise Barnes; Sheila Batts; Jeanine Bell; Cecilia Benique; Clinton Biet; Teresita Bowman; Elizabeth Browde; Annette Brown; Cora Brown; Jerelyn Brown; Leona Brown; Robert W. Brown; Roberta Brown; Ramona Bryan; Cheryl Burke; Sandra Byrd; Debbie Cannon; Pernice Carroll; Hazel Carter; Marsha Carter; Louise Chaneyfield; Sonia Clintron; Karen Cleveland; Toni Cleveland; Cora Cofield; Belinda Collier; Gwendolyn Cooper; Shirley Cooper; Shirley Corley; Antonia Creel; Deborah Davis; Kim D. Day; Ruby Dicks; Monique Dorsey; Douglas Drayton; Lovellan Dunton; Mary Dyson; Robert Edward; Beatrice Estwick; Kahesa Farmer; Sally Farmer; Margaret Fason; Carmen Feliciano; Sheri-Ann Felix; Paulette Ferguson; Francine Fortune; Latisha Frederick; Dorthy Mae Gainyard; Estelle Gibson; Geraldine Giles; Margaret Gillyard; Ethel Gladden; Modesto Gonzalez; Pamela Gordon; Concencia Gorman; Ernestine Green; Elsie Griffin; Joan Griffith; Sheila Grimes; Remona Hall; Rachel Henderson; Crystal Hollins; Sylvia Holman; Lorena Holme; Gloria Howard; Flora Hudson; Virginia Jackson; Deborah Jones; Ethel Jones; Mattie Jones; Odessa Jones; Gregory Kearse; Gladys Kendrick; Loretta Knox; Ronald Knox; Wanda Knox; Albert Langston; Barbara Lewis; Odessa McKenzie; Jean Mabry; Joseph Maddox; Arlene Madison; Donna Mahon; Darene Mallery; Gloria Marcus; Luz Martinez; Diane Mashburn; Addie Mazyck; Brenda Michel; Joann Mitchell; Theresa Moody; Letona Moffett; Willena

Moore; Medgar Evers Houses Tenants Association; Grace Morgan; Rachael Morris; Shalon Murdaugh; Rochelle Murdaugh; Edwina Murphy; Kisha Nelson; John Nixon; Lee Anne Ogbewele; Cheryl L. Page; Barbara Paign; Vonzella Palmer; Vickie Parker; Gale Patterson; Jean Penn; Rosetta Pattiford; Minnie Pierce; Essie Porter; Emma Pratt; Ronnie Pullian; Thelma Pullian; Bettie Ramizee; Carol Reddick; Raquel Rivera; Fdella Robinson; Idela Robinson; Charlotte Rodgers; Lola Rodgers; Linda Roy; Marsha Roy; Jessie Sanders; Lena Settles; Latoya Shannon; Mary Shipman; Theodore Simmons; Sylvia Simpkins; Carrie Simpson; Onella Simpson; Hazel Smalls; Sharron Smith; Sonia Smith; Latisha Spencer; Picola Spencer; Janice Staton; Jocynthia Stokes; Johnie Stovall; Carol Sutton; Evelyn Sutton; Alison Taylor; Maxine Taylor; Chester Thomas; Karen Thomas; Laraine M. Thomas; Monica Thomas; Shirley Thomas; Shana Thompson; Tenyatta Turpin Gregory; Aisha Tyler; Beverly Vaden; Virginia Vaughan; Gladys Vice; Clarice Wade; June Wallace; Sonia Wallace; Patricia Washington; Alissa Webb; Dorothy White; Banquetta Whitt; Michele Wike; Kathleen Wildmon; Dorothy Williams; Lavon Williams; Michelle T. Williams; Sarah Williamson; Nacomis Wilson; Cassandra Womack; Bonnie Worley; Evelyn Worrell; Darlene Wortham; Ethel Wright; and Tywanna Wright Gardner.

Respondents:

Medgar Evers Houses Associates, L.P.; Philip Rosenberg; Douglas Rosenberg; BPC Management Corp.; Seymour Maslow; Richard Curtis; New England Management Co., Inc.; United States Department of Housing and Urban Development; New York City Department of Housing Preservation and Development.

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PRELIMINARY STATEMENT

Petitioners Amilia Abbott and 180 other tenants of Medgar Evers Houses, a housing project composed of nine buildings located at 590, 600, 620, 630, 701, 715, 735, 745 and 755 Gates Avenue, Brooklyn, New York, and the Medgar Evers Houses Tenants Association ("petitioners"), respectfully petition for a writ of *certiorari* to review the judgment of the United States Court of Appeals for the Second Circuit in the above-captioned case.

OPINIONS BELOW

The summary order of the Court of Appeals for the Second Circuit affirming the district court's dismissal of the Complaint is unpublished and is reproduced in the Appendix at App. 1a. The opinion of the district court granting defendants' motion to dismiss the Complaint is published at 25 F. Supp.2d 116 (E.D.N.Y. 1998) and is reproduced at App. 8a.

JURISDICTION

The judgment of the Court of Appeals for the Second Circuit was entered on November 16, 1999. This Court has jurisdiction to review the judgment of the Court of Appeals pursuant to 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS

The statutes involved in the case include:

18 U.S.C. § 1341, reproduced in the Appendix at 33a.
18 U.S.C. § 1343, reproduced in the Appendix at 34a.
18 U.S.C. § 1961(1), reproduced in the Appendix at 28a.
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42 U.S.C. § 1437f, reproduced in the Appendix at 35a.

The regulations involved in the case include:

24 C.F.R. § 886.108(c)(1), reproduced in the Appendix at 37a.
24 C.F.R. § 265.10(a)(2), reproduced in the Appendix at 42a.
24 C.F.R. § 265.10(a)(4), reproduced in the Appendix at 43a.
24 C.F.R. § 200.219, reproduced in the Appendix at 39a.

Other rules involved in the case include:

HUD Handbook, *Occupancy Requirements of Subsidized Multifamily Housing Programs*, Directive No. 4350.3 Chg. 15, § 6-6A, reproduced in the Appendix at 44a.

STATEMENT OF THE CASE

In 1985, Medgar Evers Houses Associates, L.P. ("MEHALP") acquired ownership of a 315-unit housing project, Medgar Evers Houses (the "project") in the Bedford-Stuyvesant neighborhood of Brooklyn, New York. The income generated by this low-income housing project derived from a combination of petitioners' rents and rent subsidies provided through HUD's project-based Section 8 program, 42 U.S.C. § 1437f, a housing entitlement for low income families through which the United States Department of Housing and Urban Renewal ("HUD") makes monthly rent payments on the tenants' behalf to the owners of the project.

Between 1987 and 1996, MEHALP obtained regular increases in rent subsidy based upon its claims that the additional funds were needed to repair and improve the project and maintain federal Housing Quality Standards requiring all units to be "safe, decent and sanitary." These regular increases raised the project's annual income from approximately $1.2 million per year in 1987 to approximately $3.8 million per year in 1996.

From the time it acquired ownership of the project, MEHALP, together with the management companies it controlled -- defendants BPC Corp. and New England Management Co. (the "management companies") -- and the individual defendants associated with those companies, engaged in a long-term fraudulent scheme to loot funds from the project account.[1]

The total income of the project during this decade included not only the millions of rent subsidy dollars paid by HUD under its Housing Assistance Payment ("HAP") contract with the owners, but millions more paid to the defendants by the petitioners as their direct contribution to the total rent.

Under the HAP contract and accompanying regulations, the owners of project-based, Section 8 subsidized projects are obliged to deliver to the tenants living conditions that comply with federal Housing Quality Standards. Thus, the owners must certify to HUD every month that "all inspections have been completed" and the units for which assistance is billed "are safe, decent and sanitary." HUD Handbook, *Occupancy Requirements of Subsidized Multifamily Housing Programs*, Directive No. 4350.3 Chg. 15, § 6-6A. In spite the principal purpose for which all monies paid to the project must be put -- the provision of safe, decent and sanitary living conditions to the tenants, including the petitioners herein -- and, despite the substantial increases in rental income defendants received, by May, 1997 when this action was commenced, the long-term looting of the project's operation and maintenance funds had

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[1] The funds paid by tenants and HUD as rent and rent-subsidy must, by law, be kept in a project account. *See* 24 C.F.R. § 886.108(c)(1). These funds remain the property of the project and money may only be distributed to the owners as profit *provided* that conditions at the project first meet federal Housing Quality Standards.

resulted in 1,595 housing code violations, 1,188 of which were deemed by New York City housing inspectors to be hazardous to the lives, health and/or safety of the residents.

The defendants' long-term looting of the project account depended for its success on a three-pronged scheme of deception. Since one cannot steal what one cannot obtain, the first prong in defendants' scheme was designed to secure actual payment of the hundreds of thousands of subsidy dollars from HUD each month. To this end defendants mailed false certifications to the agency claiming that each unit for which it was seeking a subsidy payment was in safe, decent and sanitary condition. In this way, defendants obtained payment of more than $25,000,000 from HUD by the time this action was commenced.

The second prong of defendants' scheme to engage in the long-term looting of project funds was to prevent, forestall and/or divert any effort by HUD to use its enforcement powers. Those powers include ouster and replacement of management, assumption of mortgagee-in-possession status and, if necessary, foreclosure and recovery of ownership, to secure needed repairs and improvements and remedy deficiencies in the physical conditions and management of the project.

Whenever HUD inspectors did identify conditions in need of repair or correction, the defendants responded with a pattern of false and misleading submissions and promises to HUD regarding not only existing conditions but future plans to improve the property and/or abate violations of federal Housing Quality Standards. Invariably, defendants prepared and transmitted letters and other documents to assure HUD that they were seeking bids or had contracted for work when such work was never planned or implemented. These false

assurances of repair and improvement to the project lulled HUD into foregoing its enforcement responsibilities.

Finally, in order to avoid detection by HUD of their wholesale looting of the project's operation and maintenance funds, the defendants implemented the third prong of their scheme, consisting of the preparation and submission to HUD of dozens of false and misleading monthly and annual financial statements. These statements concealed the massive misappropriation of funds from the project account which were required to be used for the maintenance and operation of the project.

The thirteen-year pattern of mail and wire fraud through which the defendants successfully carried out their scheme to loot the project eluded official detection until the petitioners commenced this action. Following the commencement of this action, the defendants consented to HUD becoming the mortgagee-in-possession of the project and, since June, 1997, HUD has been responsible for its management.

During the thirteen-year period prior to the commencement of this action conditions at the project steadily deteriorated. Because of the relentless looting of the project's operation, repair and maintenance funds, the project was deprived of the essential funds to implement an adequate program of ongoing maintenance and regular repair, as well as necessary capital improvements. The result was the growth in squalor, disrepair, and dangerous and unhealthy conditions that inevitably ensued. By 1997, when petitioners initiated this legal action, the number of violations of local building codes had reached a staggering fifteen hundred ninety-five (1,595), with

eleven hundred eighty-eight (1,188) of these deemed hazardous to the lives, health and/or safety of the residents.[2]

That these conditions, and the concomitant injuries to the value of the petitioners' leaseholds, were in fact caused by the long-term looting of the very funds needed to operate, maintain, repair and improve the project must be taken as true for purposes of a motion to dismiss. What is at issue in this case, and what is discussed below, is: (a) whether the fact that because the predicate acts of mail fraud committed by defendants were directed to HUD, as overseer and enforcer of the HAP contract on the petitioners' behalf, rather than to petitioners to whom performance of the HAP contract's obligations and delivery of its benefits was owed, automatically precludes petitioners from establishing defendants' conduct as the proximate cause of their injuries, and necessarily renders their injuries derivative of those suffered by HUD; (b) whether the courts below extended the proximate cause analysis of *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258 (1992) beyond the language and logic of its holding; and (c) whether it was erroneous for the Court below to treat the mail and wire fraud statutes as containing the elements of common law fraud, including misrepresentation and reliance, by holding ". . . that the tenants could not establish that their injuries were proximately caused by the alleged RICO violations; [because]

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[2] The District Court opinion speculates that the poor conditions at the Medgar Evers Houses might have resulted from " . . . the defendants' poor management of the housing project." *Medgar Evers Houses Tenants Ass'n., et. al v. Medgar Evers Houses Associates, L.P.*, 25 F. Supp.2d 116, 121 (E.D.N.Y. 1998). This not only ignores the allegations of the complaint, which should be taken as true for purposes of the motion to dismiss, but also disregards the fact that the defendant management companies had met the rigorous HUD regulations requiring that they demonstrate their competency, capacity and experience in such management. (24 C.F.R. §§ 265.10 (a)(2) and (4) and 200.219).

the defendants made misrepresentations only to HUD, not to the tenants directly." (emphasis added). (Decision below at 5a).

The conflicts among the circuits on the various proximate causation issues described above have produced widely varying interpretations of the meaning of "direct" causation in civil RICO actions based upon mail and wire fraud, the appropriate scope of proximate causation inquiry, and the competing "convergence vs. non-convergence" theories regarding the elements of mail and wire fraud when those offenses serve as predicate acts in civil RICO actions.

REASONS FOR GRANTING THE WRIT

I. THERE IS A FUNDAMENTAL CONFLICT BETWEEN CIRCUIT COURTS OF APPEAL REGARDING PROXIMATE CAUSE IN CIVIL RICO CASES PREDICATED UPON MAIL AND/OR WIRE FRAUD, WHEREIN THE SECOND AND FOURTH CIRCUITS HAVE EXPRESSLY ADOPTED "CONVERGENCE THEORY" WHILE THE THIRD AND FIFTH CIRCUITS HAVE EXPRESSLY REJECTED IT.

In civil RICO cases involving predicate acts of mail and wire fraud, the most controversial and hotly disputed conflict among the Circuit Courts of Appeal and among various federal district courts, is the issue of "convergence theory." The advocates of convergence theory argue that, in order to establish both standing and proximate causation, a plaintiff must in every case be both deceived by the predicate acts and injured by them. The opponents of this convergence-of-identity requirement assert that many potential plaintiffs have been directly and proximately injured by misrepresentations made to and relied upon by third parties.

Both the Third and Fifth Circuits reject convergence theory. The Fifth Circuit Court of Appeals has repeatedly held that, in the context of a civil RICO action based upon a pattern of mail and/or wire fraud acts in furtherance of an overall scheme to defraud, that "Our guideline for the elements of RICO mail fraud is: 1) a scheme to defraud by means of false or fraudulent representation, 2) interstate or intrastate use of the mails to execute the scheme, 3) the use of the mails by the defendant connected with the scheme, and 4) actual injury to the plaintiff. *In re Burzynski*, 989 F.2d 733 at 741 (5th Cir., 1993); *see also Abell v. Potomac Insurance Co. of Illinois*, 946 F.2d

1160 at 1167 (5th Cir. 1991). Thus, in the Fifth Circuit, the civil RICO plaintiff is not required to prove reliance on fraudulent mailings to prove proximate cause. *Armco Indus. Credit Corp. v. SLT Warehouse Co.*, 782 F.2d 475, 481-82 (5th Cir. 1986) (justifiable reliance not required to plead civil RICO predicated on mail fraud; "[b]y confusing mail fraud with common law fraud, [defendant's] argument falls wide of the mark."). Furthermore, the Fifth Circuit Court of Appeals has properly followed the admonition of this Court in *Holmes, supra*, to recognize the virtual impossibility of establishing a black letter rule of proximate cause that will dictate the result in every case, and instead, determines proximate cause through an inquiry informed by the broad range of considerations embodied in that concept. *Khurana v. Innovative Health Care Systems*, 130 F.3d 143, 147 and n.5 (5th Cir. 1997), *vacated as moot*, 119 S.Ct. 442 (1998).

The Third Circuit Court of Appeals, in *Tabas v. Tabas*, 47 F.3d 1280, at 1294, n.18, (3d Cir. 1995) has held that, "Defendants' assertion that the mailings involved must themselves be relied upon by the victim of the fraud in order for a RICO claim to be established is inaccurate. As this Court stated in *Kehr Packages*, 'completely innocent' mailings can satisfy the mailing element."[3]

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[3] The *Tabas* court also held that in civil RICO complaints based on predicate acts of mail fraud, the Court is required ". . . to look beyond the mailings and examine the underlying scheme or artifice. Although the mailing is the actual criminal act, the instances of deceit constituting the underlying fraudulent scheme are more relevant to the continuity analysis." *Tabas*, 47 F.3d. at 1294, citing *Kehr Packages v. Fidelcor, Inc.*, 926 F.2d 1406, 1414 (3d Cir. 1991). Petitioners contend that examination of the fraudulent scheme is at least as relevant to sound proximate cause inquiry as it is to continuity analysis. In *Rodriguez v. McKinney*, 878 F. Supp. 744, 749 (E.D.Pa. 1995), the Court supported petitioners' view, holding: "In *Tabas v. Tabas*, . . . its most recent RICO pronouncement, the Third Circuit clarified in a footnote that

These holdings are squarely in conflict with the holdings of the Court below in this case and with decisions by the Fourth Circuit which, for purposes of establishing proximate cause, required the predicate acts of mail and/or wire fraud to contain fraudulent misrepresentations that were directly sent to and relied upon by petitioners. Thus, while the approach of the Fifth and Third Circuit Courts of Appeal would not add the additional elements of misrepresentation and reliance to the mail and wire fraud predicate acts for purposes of civil RICO, and, instead, would adopt the broad, common law proximate cause inquiry endorsed by this Court in *Holmes*, both the Court below and the Fourth Circuit Court of Appeals have adopted the restrictive, "black letter rule" approach to determining proximate cause which *Holmes* disapproves.

The Court below held that because the misrepresentations here were made to HUD, the petitioners' injuries "are therefore necessarily derivative of injuries sustained by HUD," and concluded that petition-petitioners "[could] allege no direct injury." The Court below therefore held that because petitioners did not receive the fraudulent mailings, they were precluded as a matter of law from bringing this claim.

Similarly, in *Brandenburg v. Seidel*, 859 F.2d 1179, 1187-88, n.10 (4th Cir. 1988) *rev'd on other grounds, Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706 (1996), the Fourth Circuit held that the predicate acts of mail fraud themselves must be not only the direct and proximate cause of the injuries, but also that ". . . while . . . it is not necessary to establish detrimental reliance by the victim in order to make out a violation of the federal mail fraud statute . . . *such reliance is necessary to establish injury to business or property 'by reason*

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victims of a RICO mail fraud need not demonstrate reliance on the predicate mailings themselves in order to allege a viable claim."

of a predicate act of mail fraud within the meaning of §1964(c)."[4] (emphasis added).

Thus, the requirement in the Second and Fourth Circuit Courts of Appeal that, for civil RICO purposes alone, the mailings that constitute the predicate acts must contain misrepresentations which are directly relied upon by the victim imposes severe limitations upon those who may recover under §1964(c) that are not imposed in the Third or Fifth Circuit Courts of Appeal.

The First Circuit Court of Appeals has also spoken on the question of convergence theory, although in the context of criminal prosecutions under the mail and wire fraud statutes. In *United States v. Christopher*, 142 F.3d 46 (1st Cir. 1998), the Court considered, apparently for the first time, whether the mail and wire fraud statutes were violated when the party deceived by the fraudulent communication was *not* the party who was deprived of money or property. In emphatically rejecting convergence theory, the Court held:

> Turning to whether we should now adopt a convergence theory, we see little reason to do so. Nothing in the mail and wire fraud statutes requires that the party deprived of money or property be the same party who is actually deceived. The phrase 'scheme or artifice . . . for obtaining money or property by means of false or fraudulent pretenses, representations or promises,' 18 U.S.C. § 1341, is broad enough to

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[4] Even the Fourth Circuit appears to have questioned, but not expressly disturbed, the rigid and restrictive holding of *Brandenburg*. *See Mid-Atlantic Telecom, Inc. v. Long Distance Services*, 18 F.3d 260, 263 (4th Cir. 1994).

> include a wide variety of deceptions intended to deprive another of money or property. *See United States v. Evans*, 844 F.2d 36, 39 (2nd Cir. 1988). We see no reason to read into the statutes an invariable requirement that the person deceived be the same person deprived of the money or property by fraud. *If, for example, the role of a government regulator is to protect the monetary interests of others, a scheme to mislead the regulator in order to get at the protected funds will affect 'property rights' as required in McNally.* [5]

142 F.3d at 53 (emphasis added).

The context of *United States v. Christopher*, *supra*, is different from the case at bar only to the extent that the identical mail and wire fraud statutes are being employed for different purposes. But there is no rational basis to assume that the Court's analysis in *United States v. Christopher*, *supra*, would not apply with equal force and logic when the same substantive statutes were being invoked as predicate acts in a RICO case, whether criminal or civil. The criminal defendant Christopher was accused of intentionally deceiving state insurance regulators assigned to protect the property and financial health of insurance companies in order to siphon off millions of dollars from those companies.

The respondents in this case, in order to loot the project account, allegedly subverted both federal regulations and contract obligations by deceiving HUD officials assigned to protect the living conditions of the residents, as to the physical

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[5] Referring to *McNally v. United States*, 483 U.S. 350 (1987).

state, operational and repair plans, and fiscal integrity of the project. In both *Christopher* and the instant case, the wrongdoers were obliged to deceive government regulators in order to "get at the protected funds," injuring the property rights of those entitled to the use or benefit of those funds. *Christopher*, 142 F.3d at 54.

Thus, insofar as it can be fairly assumed that the First Circuit would apply its analysis of convergence theory in *Christopher* to a situation in which the identical statutes were invoked at predicate acts in a civil RICO context, the Second and Fourth Circuits are also effectively in conflict with the First Circuit Court of Appeals as well.

Exacerbating the conflict between the circuits set forth above is the chaotic state of the law governing these questions among the district courts within the Second Circuit Court of Appeals. Within the Second Circuit, no fewer than nine district court cases share the Third Circuit's rejection of convergence theory. *See Ifill v. West*, No. 96CV6308 (SJ), 1999 WL 690144 (E.D.N.Y. Aug. 24, 1999); *Sterling Interiors Group, Inc. v. Haworth, Inc.*, No. 94 CIV. 9216 (CSH), 1996 WL 426379 (S.D.N.Y. Jul. 30, 1996); *Phoenix Home Life Mutual Ins. Co. v. Brown*, 857 F. Supp. 7 (W.D.N.Y. 1994); *Volman Distributors, Inc. v. New York Post, Inc.*, 825 F. Supp. 1153 (S.D.N.Y. 1993); *Trautz v. Weisman*, 819 F. Supp. 282 (S.D.N.Y. 1993); *Scharf v. Claridge Gardens*, No. 88 CIV. 2047 (JAC), 1990 WL 186879 (S.D.N.Y. Nov. 21, 1990); *Metromedia Co. v. Fugazy*, 753 F. Supp. 93 (S.D.N.Y. 1990), *aff'd. as amended*, 983 F.2d 350 (2d Cir. 1992); *Shaw v. Rolex Watch, U.S.A., Inc.*, 726 F. Supp. 969, 972-3 (S.D.N.Y. 1989); and *Galerie Furstenburg v. Coffaro*, 697 F. Supp. 1282 (S.D.N.Y. 1988). By contrast, at least four district court cases have embraced convergence theory. *See, e.g., Burke v. Dowling*, 944 F. Supp. 1036 (E.D.N.Y. 1995); *B.V. Optishce*

Industrie De Oude Delfl v. Hologic, Inc., 909 F. Supp. 162, 170 (S.D.N.Y. 1995), *recons. denied*, 925 F. Supp. 162 (S.D.N.Y. 1996); *Gruntal & Co. v. San Diego Bancorp*, 901 F. Supp 607 (S.D.N.Y. 1995); and *Red Ball Interior Demolition Corp. v. Palmadessa*, 874 F. Supp. 576 (S.D.N.Y. 1995).[6]

Moreover, in at least one other Circuit which has not definitively decided this issue, similar confusion reigns. Compare *Stamp v. Brown*, Nos. 81 C 1475, 80 C 6251, 1991 WL 628, *2 (N.D.Ill. Jan. 2, 1991), with *United States v. Keane*, 678 F. Supp. 708, 711 (N.D.Ill. 1987), aff'd 852 F.2d 199 (7th Cir. 1988).

As is plain from the district court decisions cited above, the courts within at least the Second and Seventh Circuits have become a legal lottery on the issue of proximate causation and "convergence" theory in civil RICO cases based upon mail and wire fraud.[7] Moreover, because the decision below was rendered in the form of a summary order, and is not binding on the district courts, confusion will continue to reign both among the circuits and within the Second Circuit until this Court speaks definitively on the questions presented here.

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[6] The district court decisions cited here are merely a sampling of the competing positions held by these courts in the Second Circuit, and should not be construed as a comprehensive list of cases which have spoken on these issues.

[7] At present, the district courts simply choose from among the various approaches the one that most appeals to them. Thus in the most recently decided district court case cited above, the Court held: "This Court concurs in Judge Haight's analysis and follow Sterling Interiors, Trautz and Shaw in concluding that a plaintiff may satisfy RICO's standing requirement by pleading that they were injured as proximate result of fraudulent acts directed at third parties." *Ifill*, 1999 WL 690144 at *11.

II. THE QUESTIONS PRESENTED BY THE DECISION BELOW REFLECT A SUBSTANTIAL DEPARTURE FROM THE PROXIMATE CAUSE ENQUIRY REQUIRED BY *HOLMES*, THE EFFECT OF WHICH WOULD PRECLUDE ENTIRE CATEGORIES OF PERSONS SUFFERING RICO INJURIES FROM THE REMEDIES PROVIDED BY THE STATUTE.

The importance of the holding by the Second Circuit Court of Appeals is that it misconstrues this Court's holding in *Holmes*:

a. to categorically exclude from use of the civil RICO statute entire classes of private plaintiffs, such as third party beneficiaries of a fraudulently breached contract, who are clearly within the zone of interest of those whom Congress intended to protect, although the injuries they suffered resulted directly from misrepresentations made to others;[8]

b. to prohibit those victims of a RICO enterprise most directly damaged in their business or property by the defendants' criminal conduct from seeking the dissolution of the enterprise that injured them and an injunction against its principals from engaging in the same or similar activities, relief uniquely provided by the civil RICO statute, as well as compensation for those injuries;

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[8] Other classes of potential plaintiffs who may be directly injured by defendants' fraudulent misrepresentations to third parties acting as plaintiffs' representatives include: persons dependent upon government regulators for the protection of their property; persons acting through their business agents or fiduciaries, owners of property entrusted to bailees, beneficiaries of trusts or estates who rely on executors or administrators, and disabled people who must act through the holder of their power of attorney.

c. to limit proximate cause inquiry in a civil RICO context to the immediate effects of the predicate acts isolated from and without reference to the fraudulent scheme they effectuated;

d. to effectively modify the federal mail and wire fraud statutes by judicially importing the requirements of (i) a misrepresentation made directly to the plaintiff/victim, and (ii) direct and immediate reliance upon those statements by the plaintiff/victim; and

e. to adopt the controversial "convergence theory" requiring that, in civil RICO actions based on predicate acts of mail and/or wire fraud, the person directly deceived and the person injured must be identical in order to satisfy the proximate cause requirement.

These judicially created obstacles to the satisfaction of the civil RICO proximate cause test have extended the proximate cause standard of *Holmes* far beyond any reasonable interpretation of that decision, and have worked a manifest injustice upon the one hundred eighty-one petitioners in this case who have suffered a drastic, long-term loss in the value of their leaseholds, and may now face a return of this housing project to the operational custody and control of the defendants.[9] (The erroneous nature of the interpretation given *Holmes* by the Courts below is argued at POINT III, *infra*.)

As this Court has yet to address the questions presented here, a distinct threat exists that other circuits will answer them

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[9] Although the "continuity" element of civil RICO actions is not at issue here, the fact that the tenants' action was dismissed not only leaves defendant MEHALP as owner of the project, but presents a real risk that it will resume its operational control.

in the unduly restrictive and unjust manner that is reflected in the decision below. (*See Holmes*, 503 U.S. at 286, 289-90, concurring opinions of Justices O'Connor and Scalia, regarding the danger of statutorily unwarranted restrictions upon and inconsistent standards for pleading proximate causation.)

The facts of this case, and the decisions below, offer this Court the opportunity to clarify the meaning of *Holmes* and resolve many of the most vexing and controversial questions regarding civil RICO proximate cause that remain unanswered.

III. THE PETITIONERS, AS THIRD PARTY BENEFICIARIES OF DEFENDANTS' CONTRACT WITH HUD, WERE NOT PRECLUDED FROM ESTABLISHING DIRECT INJURY MERELY BECAUSE DEFENDANTS' MISREPRESENTATIONS WERE MADE ONLY TO HUD.

A. The Court Below Misconstrued the Proximate Cause Holding of *Holmes*.

The holding of the Court below expresses an absolute requirement that only the recipient of a mailing containing a material misrepresentation upon which the recipient detrimentally relies can satisfy the proximate cause requirement of direct injury that must be pleaded under civil RICO. In doing so, the Court below relies upon this Court's decision in *Holmes*, despite the fact that all that *Holmes* requires is a showing of a direct relationship between the injury suffered and the misconduct alleged by the plaintiffs.

This exceptionally restrictive interpretation of the *Holmes* holding excludes from the protection and remedies of

civil RICO entire categories of persons directly and intentionally injured by the fraudulent conduct of the participants of the RICO enterprise (*see* n.3, *infra*). The excluded group in this case is comprised of third party beneficiaries of contracts in which the RICO defendants are promisors. Under such third party beneficiary contracts, the promisee typically reserves for itself the right and duty to oversee and enforce the promisor's performance of the agreement; to wit, the delivery of the benefits of the contract to the third party beneficiary. *Owens v. Haas*, 601 F.2d 1242, 1250 (2d Cir. 1979). But the contract's paramount purpose is to ensure that the third party receives the benefit. *Id.*

Accordingly, when the promisor breaches the contract -- in this case by the long-term looting scheme -- it is typically the individual beneficiaries, rather than the promisee, who are deprived of the benefits of the contract and are, therefore, the most directly and grievously injured.

In the case at bar, the decision below has resulted in the illogical and unjust result of categorically excluding the petitioners, who are in direct privity of contract with the defendants, from alleging direct injury by reason of the fraudulent breach of that contract, despite the clear factual reality that it was the tenants who were the primary victims of defendants' fraudulent scheme and who were the only parties who suffered damage to their property recognized under §1964(c).[10] The apparent reasoning of the Court below is stated

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[10] HUD did not "own" the money it paid to defendants on the petitioners' behalf to deliver safe, decent and sanitary housing to the petitioners. Rather, this money was appropriated by Congress for use at this specific housing project to deliver a specific level of housing quality to these specific residents. Were HUD to sue for restitution of the stolen funds, it would be legally obliged to return those funds to the project account, rather than to a

only as a factually and legally incorrect conclusion that the petitioners' injuries were "necessarily derivative of injuries sustained by HUD". (Decision below, p.6a).

The conclusion by the Court below that petitioners' injuries were necessarily derivative of injuries to HUD was factually incorrect for the following reason: the "injury to property" suffered by HUD was the money it ultimately had to pay to make the repairs and improvements and provide the services that were supposed to have been paid for by the misappropriated funds. By contrast, the primary damage to the petitioners' property was the drastic reduction in the value of their leaseholds. Specifically, the petitioners were contractually entitled to living conditions that met federal Housing Quality Standards (i.e., conditions that were "safe, decent and sanitary"). The monetary value put on such living conditions is set forth in the Housing Assistance Payment agreement as the "contract rent" for each unit. The more conditions fell below such federal standards, the lower the monetary value of each tenant's occupancy.[11] Thus, while both HUD and the petitioners would have had standing to sue the defendants for breach of the HAP contract, *see In Re Spong*, 661 F.2d 6, 10 (2d Cir. 1981), and obtain restitution to the project account of the stolen monies, only the tenants would have standing to seek compensation for the drastic reduction in the value of their leaseholds that resulted from defendants' looting scheme.

HUD general account.

[11] In New York, there is a routine and commonly utilized formula for establishing "rent abatement" damages, in which the trier of fact determines the percentage by which the value of an apartment unit was reduced due to poor conditions, and awards this percentage as a fraction of the monthly rent times multiplied by the number of months the poor conditions persisted.

Moreover, the conclusion that petitioners' injuries were "necessarily derivative" was legally erroneous because the Court below ignored the classic considerations informing proximate cause inquiry, and focused only on the fact that defendants' mailings were transmitted to HUD rather than plaintiffs. In adopting such a mechanical approach, the Court below refused even to consider that defendants communicated with HUD rather than the tenants simply as a matter of tactical necessity. Specifically, defendants were required by the HAP contract and accompanying federal regulations to submit to HUD certifications regarding living conditions, as well as monthly and annual financial statements and other sworn and unsworn representations regarding the operation, maintenance and fiscal integrity of the project. These submissions enabled HUD to enforce performance of the HAP contract on the tenants' behalf.

The tenants relied upon HUD, which acted as their fiduciary agent for purposes of enforcing the terms of the contract, to ensure that they received the benefits of the contract. When HUD, by reason of the predicate acts of mail and wire fraud, failed to discharge its enforcement responsibilities, the foreseeable and, indeed, inevitable consequences ensued: the steady deterioration of living conditions at Medgar Evers Houses.

As the defendants were accountable for their performance of the contract to HUD, rather than petitioners, they simply had no need to lie directly to them. However, defendants' misrepresentations to HUD about the conditions at the project and concealment of their looting from HUD were nonetheless essential not only to obtain monthly subsidy payments, but to avoid official detection of their long term scheme to defraud the project's operation and maintenance account.

B. The Highly Restrictive Proximate Cause Inquiry Employed Below Precludes the Broad Common Law Inquiry Recommended In *Holmes* And Adopts A "Black Letter Rule" Which *Holmes* Repudiates.

It could not be clearer that defendants' decision to direct their lies to HUD rather than the petitioners was dictated by purely logistical considerations, and should play little if any part in any proximate cause inquiry. On the contrary, a common law inquiry would consider such factors as:

a. whether defendants' decade-long pattern of fraudulent misrepresentations and concealment transmitted by mail and/or wire to HUD, as the administrator and enforcer of the tenants rights under the contract, played a material and substantial role in enabling defendants to loot operation and maintenance funds while avoiding official detection;

b. whether the injuries which petitioners alleged to be the natural and foreseeable consequences of the fraudulent scheme the defendants implemented through the pattern of predicate acts were direct or derivative of the injuries suffered by HUD; [12]

c. whether the practical and policy concerns underlying proximate causation, including "ideas of justice," foreseeability, and avoidance of attenuated claims by remote

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[12] It is self-evident that if defendants loot the funds intended to provide uniformed security, an increase in crime will result: if they loot the funds for extermination services, rodent infestation will increase; if they misappropriate roof repair money, leaks will persist, and so on.

parties, are met by permitting those such as petitioners herein, who are in direct privity of contract with the defendants, and who have been fraudulently deprived of the benefits promised by defendants; and

d whether the injuries alleged were more likely than not caused by an independent event and/or party than by the misconduct alleged against the defendants.

In deciding the proximate cause issue in *Holmes*, this Court did not base its holding on the fact that the non-purchasing customers were not the parties deceived by the securities fraud. On the contrary, the Court suggested that there need not be a "convergence" of identity between the person deceived and the person injured in order to satisfy the direct injury element of the proximate cause test.[13] Rather, this Court noted that "our use of the term 'direct' should merely be understood as a reference to the proximate cause enquiry that is informed by the concerns set out in the text." *Id.* at 273, n.20.

Nevertheless, the Court below equated the existence of a direct injury with the convergence in identity of the party directly deceived and the party injured, and concluded, as a matter of law, that any injury resulting from a misrepresentation the defendant made to someone other than petitioners was necessarily indirect and derivative. Such a holding cuts off any further causation inquiry before it begins, and excludes from

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[13] In footnote 19 of *Holmes*, 503 U.S. at 272, the Court observed with respect to a "parking" scheme alleged against the defendants who, without making any false statements to their customers, parked stock in their accounts and then "bought" or "sold" the stock in a series of sham transactions, that "We do not rule out that, if, by engaging in the parking transactions, the conspirators committed mail fraud, wire fraud or 'fraud in the sale of securities' . . . the broker-dealers' customers might be proximately injured by these offenses."

consideration the entire array of common law proximate cause factors recognized by this Court as central to determining whether a civil RICO injury was sufficiently direct and attributable to the defendants' misconduct to meet the proximate cause test. This ultra-restrictive inquiry is a particularly egregious departure from the broader common law inquiry recommended in *Holmes* because, unlike the facts of *Holmes*, no intervening event or alternative explanation for plaintiffs' damages has even been suggested.[14]

For all of the above reasons, the restrictive interpretation of the *Holmes* proximate cause test in civil RICO actions adopted and applied in this case by the Second Circuit Court of Appeals distorts the holdings of this Court and should be reversed.

IV. THE HOLDING OF THE COURT BELOW, IN EFFECT, JUDICIALLY MODIFIES BOTH THE CIVIL RICO STATUTE AND THE MAIL AND WIRE FRAUD STATUTES, AND DISREGARDS THE INTENT OF CONGRESS TO INCLUDE WITHIN THE PURVIEW OF CIVIL RICO THE TYPE OF "EGREGIOUS CRIMINAL CONDUCT"

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[14] In *Holmes* there were at least two intervening events which caused plaintiffs' injury: the revelation of the securities fraud to the market, causing the price to plummet, and the subsequent insolvency of the broker-dealers. In this case, the deterioration of living conditions was the foreseeable result of defendants' theft of operation and maintenance funds. A specific example alleged in plaintiffs' complaint is the claim the defendants misappropriated hundreds of thousands of dollars per year specifically earmarked to provide on-site uniformed security guards. The theft of that money was followed by a steady increase in on-site crime. No intervening event or circumstance, akin to the public revelation of the securities fraud or the insolvency of the *Holmes* case was even suggested below.

THAT DEFENDANTS COMMITTED IN THIS CASE.

There is no dispute that, while there is an implicit "materiality" requirement in the mail and wire fraud statutes, *United States v. Gaudin*, 515 U.S. 506 (1995), there is no requirement that the mail or wire transmissions themselves contain a misrepresentation or that someone acts in reliance upon them. Rather, these statutes require only that there be a scheme or artifice to defraud, for the purpose of obtaining money or property, and the use of the mail and/or wires in furtherance of that scheme. *See, e.g., Neder v. United States*, 527 U.S. 1, 119 S. Ct. 1827, 1841 (1999). In *Neder, supra*, this Court held that "[t]he common law requirements of 'justifiable reliance' and 'damages', for example, plainly have no place in the federal fraud statutes. *See, e.g., United States v. Stewart*, 872 F.2d 957, 960 (10th Cir. 1989) ('[Under the mail fraud statute], the government does not have to prove actual reliance upon the defendant's misrepresentations'); *United States v. Rowe*, 56 F.2d 747, 749 (2nd Cir. 1932) (L. Hand). ('Civilly of course the [mail fraud statute] would fail without proof of damage, but that has no application to criminal liability'")."

It is noteworthy that even the difference expressed in *Neder, supra*, between the criminal and civil showing based on mail fraud is the presence of a "damage" rather than a "reliance" component in the civil case. However, neither a criminal nor a civil case based on mail fraud contains the element of justifiable reliance.

Yet the Court below has treated the predicate acts alleged in the complaint as if, for civil RICO purposes alone, the victims of the scheme to defraud necessarily had to be the recipients of transmissions containing fraudulent statements upon which they justifiably relied. This is unsupported by either

the statutory language of any portion of 18 U.S.C. §§1961 - 1964, 18 U.S.C. §1341 or 18 U.S.C. §1343, or judicial precedent established by this Court or any Circuit Court. Moreover, it disregards fundamental principles of statutory construction. As this Court held in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), ". . . if Congress had legislated the elements of a private cause of action for damages, the duty of the Judicial Branch would be to administer the law which Congress enacted; the Judiciary may not circumscribe a right which Congress has conferred because of any disagreement it might have with Congress about the wisdom of creating so expansive a liability."

It is clear that, whatever the motive of the Court below, it has substantially circumscribed a private cause of action which Congress has conferred by radically modifying the elements that Congress has legislated.

A. The Legislative History of § 1964(c) Clearly Demonstrates the Intent of Congress that the Predicate Acts of Mail and Wire Fraud Be Considered Together With the Criminal Scheme They Serve in Order to Determine Whether Defendants Have Engaged In the Sort Of "Egregious Criminal Conduct" that Warrants Employment of the Civil RICO Remedy.

The facts of this case contain all of the factors which Congress intended to be present in order to limit the use of civil RICO's remedies by private litigants. The legislative history of civil RICO states, inter alia, that ". . . civil RICO will continue to be available to plaintiffs for use against the most serious kinds

of fraud, such as that in many of the savings and loan and bank fraud cases. It leaves in place a procedure *for attacking other major frauds and other significant criminal conduct,* but it will preclude its use in routine commercial and other disputes where much of the past abuse has occurred." (emphasis added). H.R. Rep. No. 102-312, (1991).

It is a matter of common knowledge, often announced in the media in the form of new initiatives by HUD to eliminate fraud in the national Section 8 programs, that what HUD calls "equity skimming schemes" are endemic throughout its low-income rent subsidy program. Indeed, HUD and the media have frequently attributed the looting of project funds by unscrupulous owners and managers as the principal cause of deterioration in and abandonment of many of its projects. Yet, because of budgetary constraints and drastic personnel reductions, HUD is increasingly less able to discharge its duties to the residents of these projects to enforce both federal housing regulations and the terms of its HAP contracts with specific owners. As third party beneficiaries of HAP contracts who are being deprived of the benefits of those contracts by looting schemes such as that alleged in this case, tenants actually make ideal civil RICO plaintiffs for purposes of serving the interests identified by Congress. Thus, as H.R. No. 102-312 observes, ". . . these civil suits would *supplement government action* and would attack real criminal conduct -- not just contract disputes written up to sound like crimes. These cases should, therefore, be the kind which might be brought by the Justice Department as criminal cases."[15] (emphasis added).

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[15] Indeed, an identical case to this one, *Drew Plaza Tenants Asso. v. Linden Realty, et al.*, 95 CIV. 52338 (RR), was brought by the tenants of another Section 8 project. That action, ultimately settled with defendants, alerted HUD and the United States Attorney's Office of the Eastern District of New York to the defendants' looting scheme and was directly responsible for

The petitioners are ideal as civil RICO plaintiffs for four reasons. First, because the tenants stand in direct privity with the defendants as both lessees of Section 8 leases and as third party beneficiaries of the HAP contract, they have the necessary legal standing to sue for both restitution of the looted monies and for damages for the diminished value of their leaseholds. By contrast, while HUD shares standing to sue defendants for the former, it cannot recover damages on the petitioners' behalf for the loss in value of their leaseholds.

Second, petitioners' lawsuit also serves the Congressional purpose of "supplementing government action" by directly including HUD as a non-culpable party. As mortgagee of these Section 8 projects and promisee of the HAP contracts, HUD is a necessary party to the litigation and is, therefore, entitled to all of the discovery obtained by plaintiffs, which discovery forms the evidentiary basis of any further criminal or punitive action the agency wishes to take against culpable owners and managers. This is a particularly efficient means of alerting the responsible government agency of wrongdoing and sharing the evidence gathered by plaintiffs with that agency in a prompt manner.

Third, the tenants themselves, as occupants of the looted project, provide a vast source of information and evidence about the physical conditions of the project, and can be indispensable witnesses in any later prosecution, particularly in rebutting claims by defendants that they spent project monies to provide specific repairs and services.

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the indictments of the principals (*United States v. Mochkin et al.*, 98-CR-1161 (CA)) for defrauding the project of more than $2,000,000. (*The New York Times*, 12/25/98, Sec. B., page 1).

Fourth, civil RICO is the only remedy available to petitioners that provides for the dissolution of the enterprise and prohibition of its principals from engaging in the same or similar activities in the future.

That wholesale looting of monies intended to provide safe, decent and sanitary housing for the poor constitutes the "egregious criminal conduct" contemplated by House Report No. 102-312 seems self-evident. The owners and managers of Medgar Evers Houses, by operating their enterprise through a pattern of mail and wire fraud for more than a decade, dramatically decreased the value of petitioners' leaseholds. Permitting petitioners to bring this civil RICO lawsuit would clearly serve the public interest demanded by Congress (H.R. No. 102-312) by concretely aiding official investigation and prosecution of these wholesale frauds and deterring such conduct by others, and making the petitioners whole for the severe damage to their property.

CONCLUSION

The petition for a writ of certiorari should be granted.

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Respectfully submitted,

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